



## Municipal Bond Basics

Cities, much like nations, issue bonds to support their expansions and requirements. These bonds are known as Municipal bonds, issued to increase city funding. For American owners these bonds have a single important function. They are always excluded from one level of taxation, and possibly two or more. While most bonds' interest payments are subject to federal government income tax rates, Municipal bonds are tax exempt. This is typically their one redeeming factor. They pay lower interest rates due to this tax exemption, but most of that rate is kept by the purchaser.

Municipal Bonds do not consist only of cities. They are actually a class of bond based on tax exemption status. If a bond issuer meets specific criteria that support the benefit of the greater public good, the bonds will be declared as income tax exempt by the Internal Revenue Service.

There are three potential levels of income tax free status. The first level is national exemption, which results in an exemption from national taxation. The second is state or provincial exemption, an exemption from regional taxes. The final third level is local exemption, an exemption from city taxes. Almost all municipal bonds issued have national taxation exemption. Those with an additional tax exemption are known as double tax exempt bonds. The bonds which are exempt on all levels are known as triple tax exempt bonds.

There is no reason to place tax exempt bonds in retirement accounts which already have tax reductions or exclusions. You want these bonds to be taxed at their lower rates, while placing regularly taxed bonds into accounts with tax exemptions. You should never put these bonds in a 401k, IRA, or Roth IRA.

Anytime you profit from bond trading you will have to pay taxation on municipal bonds. If you are purchasing municipal bonds at a low price, and reselling them at a higher price, you will encounter taxes. If you are purchasing and selling at a higher price within the same year, you will incur income taxes on the trades. If you purchase and sell higher after the purchase year, you will encounter capital gains taxes on the trade. Income taxes are normally taxed at a higher rate than capital gains taxes, but this depends on your tax bracket.